



Department of Energy

Washington, DC 20585

February 26, 1998

MEMORANDUM FOR THE SECRETARY

Greg Friedman

FROM: Gregory H. Friedman
Principal Deputy Inspector General

SUBJECT: INFORMATION: Report on "Audit of the Department of Energy's
Consolidated Financial Statements for Fiscal Year 1997"

BACKGROUND:

The subject report provides the results of our audit.

DISCUSSION:

The Office of Inspector General audited the Department's Consolidated Statement of Financial Position as of September 30, 1997, and the related Consolidated Statement of Operations and Changes in Net Position for the year then ended. In the opinion of the Office of Inspector General, these financial statements present fairly, in all material respects, the financial position of the Department as of September 30, 1997, and the results of operations and changes in net position for the year then ended, in conformance with the basis of accounting described in Note 1 of the financial statements.

In accordance with *Government Auditing Standards*, the Office of Inspector General issued a separate report on our consideration of the Department's system of internal controls. We reported that a systematic process needs to be developed and implemented to improve the method of estimating the environmental liability. Specifically, procedures should be adopted to update the estimate through fiscal yearend and to ensure that all known remediation costs are included. This problem was considered to be a material reportable condition, but it did not have a material effect on the financial statements because of corrective actions taken by the Department. We also reported that controls over performance measure information presented in the Overview to the financial statements need to be strengthened to ensure that information is adequately supported and properly presented. While we also considered this matter to be a reportable condition, it did not materially affect the Department's financial statements.

The audit disclosed a number of other conditions relating to the Department's system of internal controls that were not considered to be reportable conditions and did not materially affect the Department's financial statements. These matters will be communicated to the Chief Financial Officer and to heads of field elements in separate reports. The recommendations made in these reports are designed to strengthen internal controls or improve operating efficiencies.

As described in *Matters of Emphasis* in our report on the consolidated financial statements, the Department is faced with a number of uncertainties. The most significant of these is the environmental liability estimate. In addition to the uncertainty inherent in any long-term estimate, uncertainties also exist with regard to the realization of Departmental plans regarding funding, facility end-states, anticipated regulatory approvals, and projected savings from productivity and efficiency improvements. Similar concerns also exist with regard to the resolution of various administrative and legal proceedings to which the Department is a party, including issues involving the Nuclear Waste Fund. These actions may result in settlements or decisions adverse to the Government; however, the outcomes of such proceedings are not currently susceptible to reasonable estimation. The manner in which each of these matters is resolved will affect ultimate costs to the Department.

In addition to the report on internal controls, we also issued a report on the Department's compliance with applicable laws and regulations. The results of our tests in this area disclosed no compliance matters reportable under applicable audit standards.

We also performed audit procedures to test compliance with the Federal Financial Management Improvement Act of 1996. This Act requires that auditors perform tests to determine whether the Agency has substantially complied with Federal financial management systems requirements, applicable accounting standards, and implementation of the United States Standard General Ledger at the transaction level. Our procedures revealed no conditions that constituted substantial noncompliance with the Act.

MANAGEMENT RESPONSE:

Departmental Management generally concurred with the audit recommendations contained in the Department-level internal control report and has indicated that corrective actions will be taken where appropriate.

Attachment

cc: Deputy Secretary
Under Secretary
Chief Financial Officer

**U.S. Department of Energy
Office of Inspector General
Office of Audit Services**

REPORT OF THE OFFICE OF INSPECTOR GENERAL

The Secretary
U.S. Department of Energy

We have audited the accompanying Consolidated Statement of Financial Position of the U.S. Department of Energy (Department) for the year ended September 30, 1997, and related Consolidated Statement of Operations and Changes in Net Position for the year then ended. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards: *Government Auditing Standards* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 93-06, *Audit Requirements for Federal Financial Statements*, as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, the evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall presentation of the financial statements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the U.S. Department of Energy as of September 30, 1997, and the results of its operations for the year then ended in conformity with the hierarchy of accounting principles described in Note 1 of the financial statements.

Our audit was made for the purpose of forming an opinion on the Department's Consolidated Statement of Financial Position as of September 30, 1997, and related Consolidated Statement of Operations and Changes in Net Position for the year then ended. The information presented in management's Overview and the Supplemental Financial and Management Information sections is not a required part of the statements, but is supplementary information required by OMB Bulletin No. 94-01, *Form and Content of Agency Financial Statements*. We have considered whether this information is materially inconsistent with the above statements. Such information has been subjected to limited auditing procedures applied in the audit of the financial statements, and accordingly, we do not express an opinion on it. The performance information included in management's Overview is addressed in our audit report on the Department's system of internal controls.

Management has chosen for purposes of additional analysis to incorporate the Executive Summary from the Department's Report on Compliance with the Federal Managers Financial Integrity Act of 1982 in its Annual Report. This Summary is not a required part of the consolidated financial statements. While such information has been reviewed separately by the Office of Inspector General, it has not been subjected to auditing procedures applied in the audit of the consolidated financial statements, and accordingly, we do not express an opinion on it.

MATTERS OF EMPHASIS

As described in Note 13 of the financial statements, the Department changed its method of estimating its environmental remediation liability for Fiscal Year 1997. The change in method resulted in a reduction in the estimated unfunded liability of about \$49 billion, from \$228 billion reported for Fiscal Year 1996, to \$179 billion recorded at September 30, 1997. The primary reasons for such change are the adoption of a remediation approach designed to accelerate cleanup at most of the Department's sites and the change in end-state assumptions for a number of facilities assigned to the Environmental Management (EM) Program. As with previous estimation methods, the estimate continues to be based on assumptions regarding actions that are to take place in the future and is highly uncertain. In addition to the uncertainty inherent in any long-term estimate, the following factors impact the overall uncertainty of the estimate:

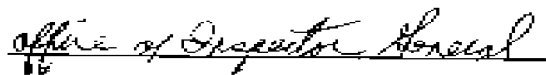
- The impact of potential changes to planned facility end-state or land-use assumptions could be profound.
- Congressional appropriations may not be received at the levels anticipated.
- The planned approach and scope of work for many remediation projects are subject to regulatory approval.
- Cost increases caused by future inflation may occur.
- Complete information as to the extent of contamination is not available for facilities that have not been completely characterized.
- The Department may be required to fund disposal costs for depleted uranium (including depleted uranium generated by the United States Enrichment Corporation).
- Projected savings attributable to efficiency and productivity improvements included in lifecycle cost estimates may not be achievable.
- Opening of the planned repository for storage of high-level waste and spent nuclear fuel may be delayed and projected waste volumes may exceed planned capacity.
- The portion of the accrued liability related to the Department's Accelerated Cleanup Plan is based on the adjusted mid-point of estimates derived from differing funding assumptions: a range of about \$11 billion.

- The Department's estimate of disposal fees for high-level waste was prepared during Fiscal Year 1995 and has not been updated to reflect major changes in assumptions. The estimate is to be updated during Fiscal Year 1998 in conjunction with a Congressionally-directed study and may increase.
- Remediation costs for contaminated facilities not yet assigned to the Department's environmental management program are based on computer modeling rather than lifecycle cost estimates.

The Department also is a party to various administrative proceedings, legal actions, and tort claims that may ultimately result in settlements or decisions adverse to the Government, as discussed in Note 16 of the financial statements. The Office of General Counsel, in responding to our inquiries about these matters, was not able to form a conclusion as to the likely outcome or potential loss resulting from litigation, claims, and assessments against the Department. Readers of the Department's consolidated financial statements should, therefore, be aware that the statements may be affected by uncertainties concerning the outcome of claims described in Note 16, which are not currently susceptible to reasonable estimation.

REFERENCE TO OTHER REPORTS

In accordance with *Government Auditing Standards*, we have also issued a report on our consideration of the Department's system of internal controls and a separate report on its compliance with laws and regulations. Both reports are dated December 29, 1997, except as they relate to the following two items. As to Note 13, the date extends to January 30, 1998, the date on which field work was completed on procedures required to update the environmental liability estimate. As to Note 16, the date extends to February 19, 1998, the date through which several motions and lawsuits were filed by various entities related to the Department's compliance with the Nuclear Waste Policy Act.


Office of Inspector General

December 29, 1998, except for Note 13, as to which the date is January 30, 1998, and Note 16, as to which the date is February 19, 1998.